CPA Firm Internal Succession

Presented by

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Transition Advisors, LLC

National consulting firm working exclusively with accounting firms on issues related to ownership transition

Succession Challenges

- 70% + of sole proprietors are 55 years of age or older
- 67% + of multi-partner firms will have at least one owner retire within five years
- 36% of multi-partner firms will have at least two owners retire within five years

2012 PCPS Succession Survey

Succession Challenges

38% of multi-partner firms responding to the survey felt younger members of their firm are not ready to step into leadership roles

2008 PCPS Succession Survey

Succession Challenges

Your personal and firm situation is unique to you

However, understanding the demographic challenges in the profession is important as you compete with other firms for succession solutions

Bottom line: there are thousands of firms in the same situation regarding succession your firm is in!

Assessing Your Firm's Succession Readiness

Two Issues to Focus on Regarding Partner Succession

- Timing-when is each partner likely to slow down substantially or retire altogether (not often seen)

- Replace-ability-how will you replace that partner's role in the firm

Assessing Your Firm's Succession Readiness

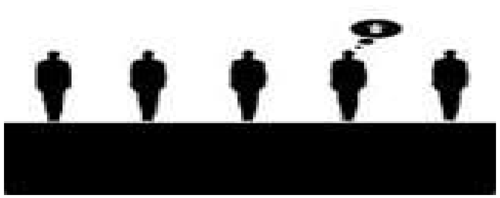
Two ways to replace a partner in your firm

- Role re-allocation
- Role succession

Assessing Your Firm's Succession Readiness

Role Re-allocation

- If sufficient capacity: retiring partner's duties are re-allocated to remaining partners
- Usually client management, technical expertise, admin duties
- Productive capacity still has to be replaced to maintain revenue



Assessing Your Firm's Succession Readiness

Role Succession

- Partner's role has to be replaced with a new partner
- Duties might still be shifted but existing capacity at partner level is insufficient in general
- Roles to be replaced include client management, practice development, special expertise

Assessing Your Firm's Succession Readiness

Brand vs Partner Loyal Clients:

Brand:

Takes less time to execute

Partner:

Must start the process earlier

Assessing Your Firm's Succession Readiness

Transitioning Roles

- 2 years minimum
- Active involvement of transitioning partner
- Respect the personal nature of relationships (especially clients)

Every client has options

Assessing Your Firm's Succession Readiness

Transitioning Roles

- Most clients are physically seen annually
- 2 years is two visits!
- First visit is the hand off
- Second is for back up purposes
- Clients 4 fears

Make the exit a non-event for staff and clients!!

Assessing Your Firm's Succession Readiness

Partner Succession Projection

Partner	1-3 yrs	4-7 yrs	>8 yrs
A	RR		
B		RS	
C		RS	
D			RR
E			RS

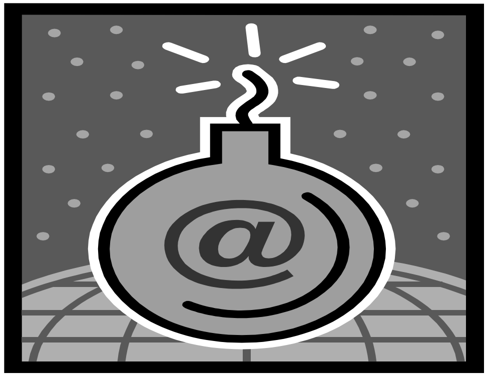
RR=Role Reallocation   RS=Role Succession

Assessing Your Firm's Succession Readiness

Succession Projection

- Role Succession in 1- 3 years is critical status: must find replacement immediately
- Role Succession in 4 to 7 years is serious- ideally replacement in place before the 3 year mark, preferably the 5
- Remember to replace the role, not just the body

Assessing Your Firm's Succession Readiness



Decision Point

Can you provide the necessary replacements for your retiring partners in time?

Developing an Internal Succession Team

Four Step Process

Step 1-Obtain the necessary talent

Step 2-Develop the talent into internal successors

Step 3-Make sure you have a proper financial arrangement

Step 4-Develop a transition plan in detail

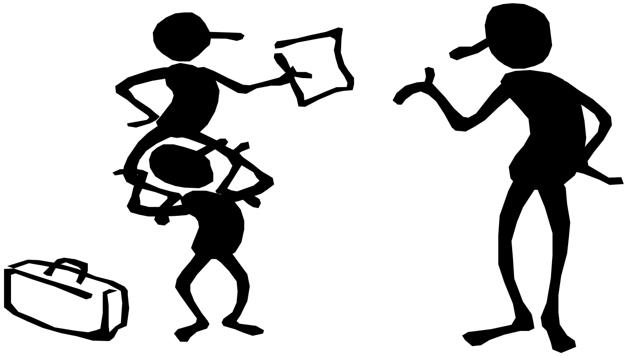
Obtain the Necessary Talent

- Hire inexperienced and low experienced talent
- Hire near partner or partner level talent
- Merger or acquisition
- The offer…

Obtain the Necessary Talent

When Hiring Low Experience Talent…..

Hire to job description for a partner to find partner talent



Obtain the Necessary Talent

Characteristics of a Partner

- Technically competent in chosen field
- Good at training and developing people
- Ability and desire to bring in new business
- Willing to do extra things for the good of Firm
- Poised; someone staff look up to
- Leadership skills
- Creative thinker
- Presence in the community
- Has **excellent** relations with clients
- Can comfortably speak to groups
- Is effective with billings and collections
- Has a passion for the success of the Firm – this is not just a job
- Is reliable and trustworthy – can be counted on to protect the Firm and its Partners/Principals
- Takes on a role in firm administration
- Has good relationship with peers
- Has relationships in the CPA community
- Can mange a $1 million - $1.5 million book of business
- Is a good business person
- Will be a complement to existing Partners and enhance chemistry of Partner group
- Is effective at recruiting for the firm

Obtain the Necessary Talent

When hiring near partner talent consider….

- Be prepared to make a lucrative offer to entice them
- Might have to take a temporary step back in compensation
- Make a solid plan and commitment for promotion to partner
- Understand they may bring a different culture

Obtain the Necessary Talent

When Seeking Partner Talent in a Merger…..

- Most firms seeking mergers have succession issues too
- Be prepared to absorb more than you are looking for-unwanted clients, succession issues, location
- Look for firms that have diamonds in the rough

Can be your fastest path to a solution if successful!!

Types of Merger

- Mini Merger: adding one to two partner firms with books of business
- Upstream merger: this will typically involve three deals within one:
  - Immediate sale
  - Two stage sellers
  - Merger for partners not seeking succession or role reduction typically for 6 years or more
  - Equity, Comp, Look Back periods, De-Merger

Develop Talent Into Internal Successors

Continually assess candidates against the job description for partners

- Train to overcome shortcomings
- Make partner development a part of the ongoing discussion with your best candidates
- Don't hesitate to cut bait and fish elsewhere

Develop Talent Into Internal Successors

Generic Competency Development

- Classroom training
- Online, books, videos
- College and specialty development courses

Firm Culture Specific Development

- Assignments-on the job training
- Increasing roles
- Income partner status (New Partner Types)

Ideally before becoming a partner candidates have functioned as one

Financial Arrangement

Structure an agreement that is win-win for:

- The firm and a new partner buying in
- The firm and a retiring partner

Keep in mind……

- *People don't make investments to lose money*
- *Don't expect the remaining partners in a retirement buy-out or a new buying-in partner to take step back in compensation to make the investment*

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19. Which of the following does your firm use to calculate the retirement benefit (just the deferred compensation, guaranteed payment, etc. portion of the benefit)? (Select the best answer.)

	< $500,000	$500,001 - $1,000,000	$1,000,001 - $2,000,000	$2,000,001 - $3,500,000	$3,500,001 - $5,000,000	$5,000,001 - $8,000,000	$8,000,001 - $15,000,000	$15,000,001 - $20,000,000	$25,000,001 - $50,000,000
We have no agreement at this time to pay a retirement benefit	76%	59%	48%	33%	22%	0%	3%	0%	0%
Multiple of salary	0%	5%	5%	5%	12%	36%	61%	29%	33%
Ownership percentage times annual net revenues	14%	22%	26%	25%	25%	28%	24%	18%	33%
Client book of business	6%	9%	12%	15%	14%	15%	0%	6%	0%
Other	4%	6%	10%	22%	27%	21%	13%	47%	33%

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Transition Advisors

Which of the following best approximates how you value the ownership interest in the firm to calculate the retirement benefit? (I.e., percent ownership equity times net annual revenues times 80 cents on the dollar, etc.)

	< $500,000	$500,001 - $1,000,000	$1,000,001 - $2,000,000	$2,000,001 - $3,500,000	$3,500,001 - $5,000,000	$5,000,001 - $8,000,000	$8,000,001 - $15,000,000	$15,000,001 - $20,000,000	$25,000,001 - $50,000,000
less than 50 cents on the $1	0%	0%	0%	0%	0%	10%	0%	0%	0%
50 cents on the $1	17%	11%	7%	4%	0%	0%	0%	0%	0%
55 cents on the $1	0%	0%	0%	0%	0%	0%	0%	0%	0%
60 cents on the $1	0%	0%	0%	0%	0%	0%	11%	0%	0%
65 cents on the $1	0%	5%	0%	0%	8%	10%	0%	0%	0%
70 cents on the $1	0%	0%	3%	0%	0%	10%	22%	33%	0%
75 cents on the $1	0%	5%	14%	0%	15%	20%	22%	0%	0%
80 cents on the $1	17%	5%	3%	22%	8%	20%	33%	33%	0%
85 cents on the $1	0%	11%	10%	4%	8%	0%	0%	0%	0%
90 cents on the $1	0%	0%	3%	0%	0%	0%	11%	0%	0%
95 cents on the $1	0%	5%	0%	0%	0%	0%	0%	0%	0%
$1 on the $1	67%	47%	24%	70%	62%	30%	0%	33%	67%
$1.05 on the $1	0%	0%	0%	0%	0%	0%	0%	0%	0%
$1.10 on the $1	0%	0%	7%	0%	0%	0%	0%	0%	0%
$1.15 on the $1	0%	0%	0%	0%	0%	0%	0%	0%	0%
$1.20 on the $1	0%	0%	0%	0%	0%	0%	0%	0%	0%
$1.25 on the $1	0%	5%	17%	0%	0%	0%	0%	0%	0%
More than $1.25 on the $1	0%	5%	0%	0%	0%	0%	0%	0%	0%
Not Applicable	0%	0%	10%	0%	0%	0%	0%	0%	33%

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22. Which of the following best approximates the magnitude of the multiplier you use pertaining to average salary to calculate the retirement benefit (i.e., one year's salary times 2)?

	< $500,000	$500,001 - $1,000,000	$1,000,001 - $2,000,000	$2,000,001 - $3,500,000	$3,500,001 - $5,000,000	$5,000,001 - $8,000,000	$8,000,001 - $15,000,000	$15,000,001 - $20,000,000	$25,000,001 - $50,000,000
[illegible] than one year's salary	0%	25%	20%	0%	0%	0%	9%	0%	0%
One year's salary	0%	25%	0%	20%	20%	7%	13%	0%	0%
One year's salary times 1.5	0%	0%	0%	0%	20%	7%	13%	0%	0%
One year's salary times 2.0	0%	0%	20%	20%	20%	7%	4%	20%	33%
One year's salary times 2.5	0%	0%	0%	0%	40%	14%	22%	20%	0%
One year's salary times 3.0	0%	25%	40%	60%	0%	43%	35%	40%	33%
One year's salary times 3.5	0%	0%	0%	0%	0%	14%	4%	0%	33%
More than one year's salary time 3.5	0%	0%	20%	0%	0%	7%	0%	20%	0%
Not Applicable	0%	25%	0%	0%	0%	0%	0%	0%	0%

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Financial Arrangement

Backwards Valuation

The retiring partner's foregone compensation has to

- Cover replacement resources
- Pay for the buyout including working capital
- Leave some upside for the remaining partners

Financial Arrangement

Typical Internal Valuation Multiples in the Profession

- 65% to 100% of fees for multiples of gross times equity

- 2.0 to 3.0 times average annual compensation

- Plus capital accounts

Trend is for valuations to decrease

Financial Arrangement

Package of terms

- Number of years paid
- Tax treatment of payments
- Adjustments for retention or lack of adequate notice
- Pay up front for capital vs over time

Financial Arrangement

New Partner Buy-ins

- Make sure the buy-in is reasonable compared to compensation
- Delay if possible payment for intangible value until partners retire and leave behind compensation
- Share in the growth without selling the current value

Options If Internal Succession Fails

- Cull out sale

  Think about down sizing to a level your remaining partners can handle: How To Value it….

- Upstream merger

  Give your firm at least 2 to 3 years to find a suitable merger partner before you have to find a replacement for retiring partners

For More Information

Please visit our website for resources including FREE reports, whitepapers and case studies.

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